RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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LETTER 1122 **May 26, 1993**

OPENING ITEMS: In my opinion, what we are now seeing is the early beginning of the "big switch" -- from financial assets (stocks and bonds) to tangible assets (precious metals, gems, etc.). Remember, I'm talking about the big switch, and big switches take time.

The conventional wisdom holds that "the stock market won't be in trouble until interest rates turn up." The Fed controls the short rates, but the rates on the long Treasury bonds (I'm sure you've noticed) are back over 7%.

With the banks now up to their eyeballs in Treasury bonds, the Fed (ironically) is locked in to a low interest rate stance (the last thing the Fed wants is for rates to rise and the banks to get socked with declining bond portfolios). The Fed dilemma -- with early inflation signs appearing, should they tighten? On the other hand, with the economy still sluggish, should they loosen?

The resumption of the bull market in gold finds the public and almost all the funds out of gold and on the sidelines. But count on it, in due time, they'll want in. At this point I seem to remember a phrase I heard many years ago. It goes something like this -- "There's no fever like gold fever." The temperature is rising, but we haven't seen real gold fever yet.

THE STOCK MARKET: The stock market has been "churning" away. This year has already produced four of the biggest volume months in all stock market history. On May 19 the Dow made history by closing at 3500.03. Yet as this is written the broad NYSE Composite is up only 3.4% for the year, the S&P 500 is also up 3.4% and the very broad Wilshire 5000 has only gained 3.2% for the year.

What this means is that there has been a lot of switching and "moving around" with not too much progress. This type of high-volume, little-movement syndrome is called distribution, and normally it's characteristic of a market top.

But wait -- against all the churning is the fact that the cautions and the warnings about the stock market are coming out thick and fast. Almost every day in the *WSJ* or the *NY Times* or *USA Today* some analyst is warning us about "overvaluation" or "too much public participation" or "the sluggish economy." And the short interest is at a record high. Bear markets aren't born out of this kind of sentiment. It's almost as if analysts (with the exception of Lehman's optimistic Elaine Garzarelli) are afraid to be bullish.

Nevertheless, the bearishness is not without foundation. Over the last year almost every stock group has been hit, some of them hit hard. I talk to investors by the dozens, and the majority of them now complain of losses. Despite the record high Dow, it's been a difficult year for most investors.

The chart (see page 2) of the broad S&P 500 Composite is a puzzle. The S&P has a "toppy" look, but the most recent spike-rally gives it a mysterious look -- as if the market doesn't know whether to go up or down.

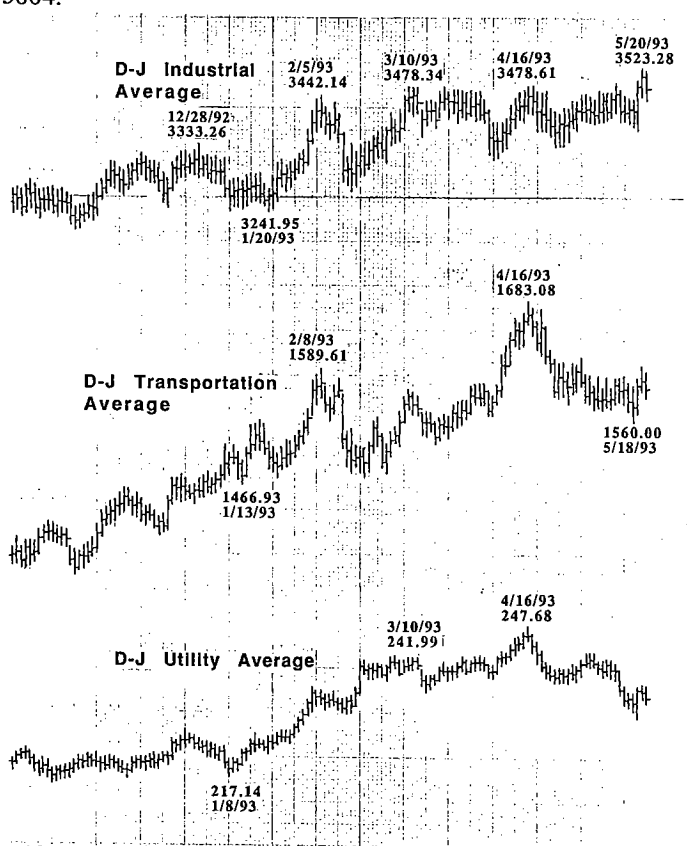
The D-J Transportation Average dropped sharply, then rallied but the rally failed by a wide margin to confirm the new record highs in the Dow. The Utility Average too, has failed to join the Dow on its solo trip to record highs.

May 14 DJIA 3443.01; PTI 3795; A-D Ratio -4.95
May 21 DJIA 3492.83; PTI 3798; A-D Ratio -4.96
Dow Yield: 3.15%; Dow Price/Earnings: 31.7
Dow 200-day MA: 3325; Dow 30-day MA: 3431
Dow Times Book Value: 2.68; PTI 89-day MA: 3753
Percentage of Undervalued Blue-chips: 7%
Low Risk Buy Index: +64

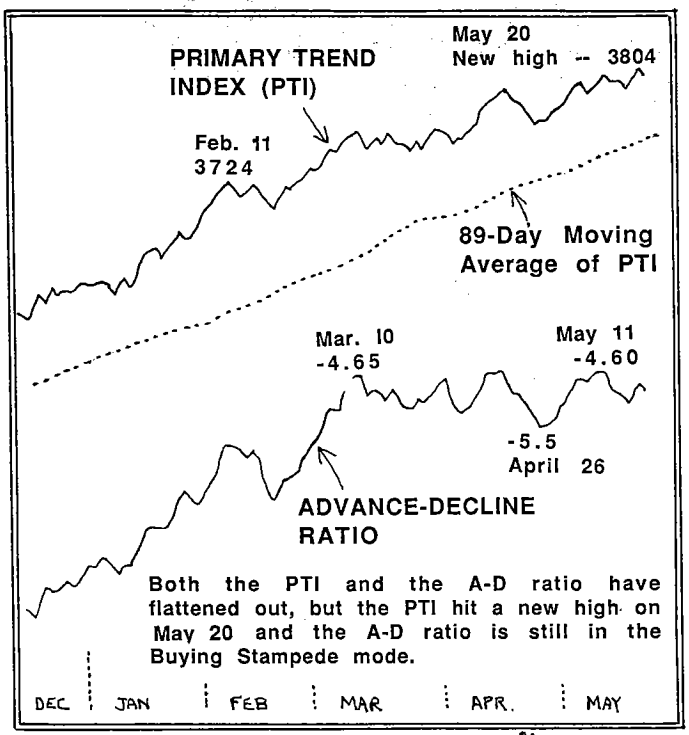
Believe it or not, the "Buying Stampede" which began last October 9 is still in force. The Stampede concept, of course, is based on the action of the advance-decline ratio. As detailed in recent Letters, the A-D ratio (see page 2 chart) has made three attempts at ending the Stampede, but each time the A-D ratio has fallen short of a full point decline.

In all my years of watching the markets, I've never seen this kind of action from the A-D ratio, but there it is -- a buying stampede that is going into its seventh month, a buying stampede that has survived three attacks by the bears, a buying stampede that has turned very sluggish -- but a buying stampede that remains intact.

As for my Primary Trend Index (PTI), it too remains in the bullish mode. To turn bearish, the PTI would have to break below its 89-day moving average and remain there. That just hasn't happened. Furthermore, on May 20 the PTI advanced to a record high of 3804.



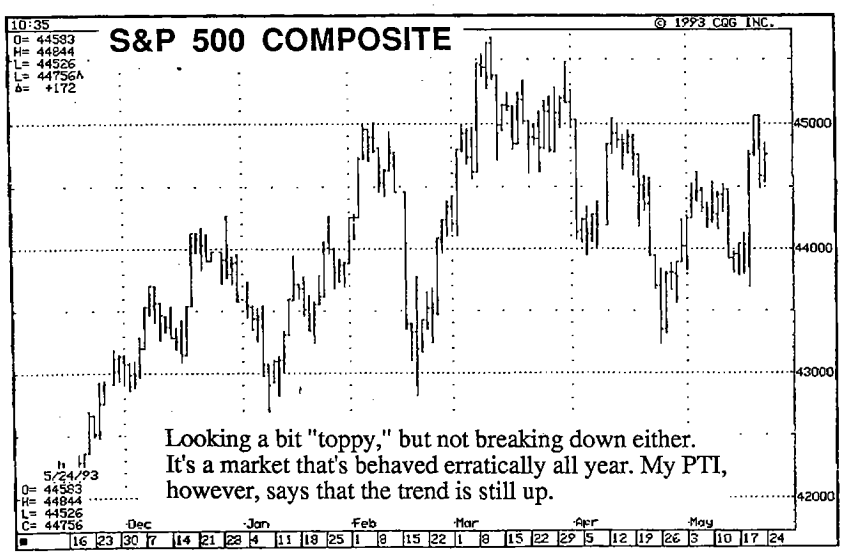
Ah yes, another non-confirmation on the part of the Transports. And the Utilities have been heading down, probably worrying in advance about a rise in interest rates.



INVESTMENT POSITION: If I'm correct, and I believe I am, if the bull market in gold has resumed, then obviously gold is where we should be.

From experience I've learned the following: (1) Most people will not get in at the early stages of a bull market. It takes a long time before people can be convinced that a bull market is actually underway. (2) People tend to trade in and out of bull markets. Very few investors remain invested with a bull market during its entire span (secondary corrections tend to knock investors out of their positions). Let me put it another way -- the most difficult procedure in investing is to stay with a bull market -- from its early stages to somewhere near the top.

My old buddy, Kennedy Gammage (he writes the *Richland Letter* here in La Jolla) notes that there are a few advisors who are smart enough to get you into a bull market near the bottom. And there are a few advisors who are astute enough to get you out of a bull market near the top. Unfortunately, they are never the same person.



Looking a bit "toppy," but not breaking down either. It's a market that's behaved erratically all year. My PTI, however, says that the trend is still up.

At any rate, I'm telling my subscribers that this is the time to have a position in gold and gold shares. Last week Spain devalued its peseta by 8%, their third devaluation in the last year. Portugal followed by devaluing its escudo by 6 1/2%. One by one, the fiat (paper) currencies of the world are devaluing. As the various currencies lose their purchasing power, informed investors move into gold.

I think this trend of competitive devaluations is going to continue, possibly even accelerate. Almost all nations are now running deficits, and as night follows day, deficits are "solved" via inflation. The problem for the world's central banks -- keeping their various economies and currencies afloat while at the same time masking their inflationary actions.

As I said, this is the EARLY part of the game. The big moves, the huge moves in gold and gold shares, lie ahead. But the early stage of the second phase of any bull market is always a difficult one for investors. Those who bought gold and gold shares at or near the bear market bottom (1985) already have fat profits, but remember, by far the greatest part of the bull market is yet to come.

I feel a bit ashamed of talking about "the best to come for gold," because what this really means is a further and perhaps climactic collapse in the dollar's purchasing power. But I don't want to mince words; I'm afraid we'll see the time when fixed income securities denominated in dollars are a dirty word (or should I say a dirty phrase). As enthusiastic as the public is today regarding bonds, that's how much they'll hate the bonds as the dollar suffers crushing losses in its purchasing power.

Let me put it this way. If I had to make a prediction of what lies ahead say 10 years from now, I wouldn't do it regarding the stock market, I wouldn't do it regarding real estate or land prices or jewelry or art. I would do it regarding the purchasing power of the dollar. I'd predict the purchasing power of the dollar will be dramatically DOWN.

Next, many months ago I recommended the Benham European Bond Fund. I now recommend that you switch this Fund into the Benham Gold Fund. All it takes is a telephone call to Benham.

Most of the gold shares spiked up over the last few weeks. Spikes usually give way to corrections. It's impossible to predict just how gold and gold shares will move from here. In a bull market, you get in, you sit tight, you let the power of the primary trend work for you. And last but not least, you refrain from jumping in and out -- you take your position, and you let the trend be your friend.

A few months ago I told my subscribers that I was buying gold calls, specifically, the December 400s. I suggested that my subscribers do the same. At the time the December 400s sold at 90 cents to $1.10 area. On May 19 these options sold as high as $18. I bought I load of these options, and I'll probably hold them until mid-November when they expire.

I've also received a number of inquiries on something I've been doing -- selling options on the currencies. I've written a paper on this -- if you're interested send a self-addressed envelope with two stamps and you may have a copy, no charge.

Note: The March trade balance was a horror, soaring to $10.2 billion, the worst showing in four years. There was a 21.8% rise in crude oil. This is very significant. Oil production in the US is sagging, and more and more oil has to be imported. This is a negative for the dollar, and by implication a positive for gold. Also, with all of Europe in a slump, our exports are dropping off. So imports are rising and exports are falling, the ultimate prescription for a disastrous series of trade balance figures.

If Clinton believes that a "cheap dollar" is going to solve the trade balance problem, he's whistling in the wind. Remember, all oil is purchased in dollars. Lower dollars mean bargain oil for Japan. And, of course, lower dollars mean unhappiness for oil producing nations.

NOTES & QUOTES: This is just a clip from the May 16 *Parade* magazine. The rumor is that several Secret Service operatives asked to be taken off the Clinton assignment because of various unpleasantries. Well, I can tell you that not only is Clinton getting on Hillary's nerves, he's getting on my nerves too.

> **Q** *Is there any truth to rumors making the rounds in Washington that Bill and Hillary Rodham Clinton have been getting on each other's nerves? Have they been hollering at each other? And did the First Lady actually throw something at the President?—Alexandra Stolley, Cleveland, Ohio*
>
> **A** Those rumors—which is all they are—were reportedly started by talkative Secret Service agents, who witnessed the Clintons having what might be called a "spirited discussion." But all available evidence indicates that the Clintons, married since 1975, have a good relationship, if at times an explosive one.

* *

In his May 17 column, William Safire writes that Clinton is like a tie salesman. "A tie salesman spreads out an array of merchandise on the counter, and if it doesn't appeal -- out comes another bunch of ties. How about this -- or this? You like this?"

The newspaper columnists in general have turned sour on Clinton. They say he's "unfocused," he's running in all directions, he's waffling, he lives by popularity polls. The super-liberal *NY Times* surprised me in their May 19 editorial when they wrote about "middle class constituents who complain, with justification, that they elected Mr. Clinton because he vowed to lower their taxes, cut wasteful Federal spending and reduce the oversized deficit. What Mr. Clinton now offers them instead is a hundred-billion dollar tax hike, minimally reduced Federal spending and a deficit barely below George Bush's levels."

I'll tell you what's basically wrong. The whole darn Clinton tax and spend program is wrong. The Democrats can't come out and admit it (yet), but they're getting strong feelers from their constituents. Nobody wants taxes raised. Nobody wants more government "investment." What they do want is REAL CUTS IN GOVERNMENT SPENDING. Clinton seems incapable of taking in the message.

As far as the latest Clinton "trial balloon," a trust fund to reduce the deficit, when Bush thought that one up, they called it a gimmick. It's still a gimmick. It won't stop the government from running deficits of over a billion dollars a day. Listen, there's only one thing Clinton wants to do -- and that's to raise your taxes. Why raise your taxes? So he can continue to spend.

So I ask myself whether there's any chance the whole Clinton program can just flush down the drain? I don't know the answer to that one, but here are the Russell odds -- I'd say the odds have dropped from 90% to 70% that the Clinton program will pass the Senate. As for Hillary's "stealth-health" program, I'd say that expensive turkey's not going to happen -- at least not this year.

Actually, President Clinton is an interesting study. On the face of it, he's a man of the people, a true populist. When he makes a speech, he takes off his jacket and stands in his shirtsleeves. He removes beer from his "sin tax" schedule, because he sides with the working man (i.e., the mass of voters) and the working man's gotta have his suds. As for the union, why Clinton even lets those bad air traffic controllers return to their jobs (after Reagan fired them all). But wait, Clinton is also star-struck. A long list of Hollywood's glamour guys and girls form an endless parade through the White House (heck, Clinton even sat next to Sharon Stone during dinner). Aw, c'mon, Ronnie and George loved rich people, why can't Bill love movie stars?

* *

Forbes magazine seems to be turning against the president. In its latest issue, a *Forbes* writer warns that the US may be developing "the Swedish Disease." The article states, "The Clinton administration's liberals who are pushing for more taxes, a bigger welfare state, bigger labor unions, currency devaluation and an industrial policy, should take note: the Swedish model is doing abysmally." However, the fact is that the Swedes are actually turning against Socialism. The Swedish New Democracy Party's Wachtmeister warns, "Right now I'd rather be in Sweden than the US, because we have seen the problems and we are moving away from the welfare state. On your side, you are moving right into it, and you risk destroying your country."

* *

The election of a new Senator (to take Bentsen's place) in Texas is becoming a referendum on Clinton. If Republican Kay Hutchison wins in Texas, it will be the first time in Texas history that the state has had two Republican Senators. Of course, the last thing Clinton wants is one less Dem and one more Republican in the Senate.

* *

Here's what really scares the Democrats (from a Kevin Phillips column in the *Washington Post*): "It's reasonable to assume that the Republicans will do well enough in the 1994 elections to wind up with 47 to 48 senators and 190 to 195 House members. If so, that would be the largest ratio of Republicans a Democratic president has had to face since Truman in 1951-52."

* *

Star Wars is history. Aside from the research part of it, I always thought Star Wars was a turkey. However, SW's demise will cost California over $1 billion in annual contracts and thousands of jobs. The Golden State has enough troubles (deficits, deficits, deficits), but California better face it -- there'll be military cuts for years to come.

* *

More notes from the West: My son, Ryan, goes to La Jolla High (a public school). Two students from the school just won top honors at the 44th annual International Science and Engineering Fair, held in Mississippi. More than 800 students from 17 countries competed for prizes. La Jolla High proudly produced two winners: their names -- Constance Chen (age 17) and Eric Wong (age 17).

* *

The May 17 *WSJ* ran a lengthy article entitled, "Indicators Point to Coming Asian Century." They quote Singapore's Minister of Information as saying, "In 25 years the combined GNP of East Asia will be larger than all of Europe's and twice that of the US." Russell comment: I wouldn't bet against it.

* *

On May 17 two gunmen walked into a bar in Fresno, California, and opened fire, killing seven people and wounding two more. The item made a little column on the third page of the *LA Times*.

* *

News for suckers: For the third quarter of '93 slot machine revenue in Nevada was up 44% from the same quarter in '92. If you've ever been to Vegas, it's fantastic to watch people send their money down the drain via the "one-armed bandits." You have to wonder what in the world they're thinking of.

* *

Why do they love the Swiss franc? Answer: (1) Switzerland has no debt and a balanced budget. (2) Swiss law calls for a 40% gold backing for each Swiss franc at the official price of $42.22 per ounce. (3) Switzerland holds 56% gold backing for the franc (but at the real market price of gold, Switzerland holds many times the gold backing needed to equal the value of a Swiss franc). (4) Switzerland also holds 20% in US dollars in reserves, but even though the franc is not redeemable in gold, the franc obviously has intrinsic value (the foregoing courtesy of Lou Parente, senior advisor for B.F.I. Consulting, AG).

* *

I've been saying this for a couple of years, but the *WSJ* finally headlined it -- "A Satellite TV System Is Quickly Moving Asia Into the Global Village -- Millions Now Watch CNN, US Soaps, and 'Lifestyle of the Rich and Famous.'" Millions of satellite dishes are going up all over Asia, and the sat-craze has moved out of the

control of the various governments. I said long ago that TV would be the death of communism. The slaves of communism saw what the capitalist world was producing and how people lived in the non-communist world, and the slaves were amazed. They realized that communism had failed to produce the good life.

With that realization, the Soviet empire collapsed. The next stage is China. There the government has seen the picture and realized that communism doesn't produce. The Chinese leaders also realized that if they didn't go the free-market route, China would go the way of Russia. Result -- free enterprise is overtaking China. Hope of the Chinese leaders -- they can remain in control despite TV and despite the advent of free markets. Note: AsiaSat 1, a $300 million joint venture, now beams to 38 countries with a combined population of 2.7 billion.

* *

Ah, the US tax system, what a destructive mess. Get this -- H&R Block collected a record $1.07 billion (yes, that's billion) in tax preparation fees during 1993. I'll say it again -- get rid of ALL taxes (corporate, individual, estate) and replace those taxes with a national sales tax. And get rid of the whole tax industry. The nation would boom.

* *

How big are the various nations' economies? Total 1992 world output is estimated at $20 trillion. The biggest economy is the US at $5.445 trillion GDP. Japan comes next at $3.140 trillion GDP. Germany is third at $1.411 trillion. France comes in at $1.099 trillion. Italy has $970 billion. Britain at $923 billion. Canada at $542 billion. Spain at $429 billion. The coming giant -- China, but estimates of is GDP are sketchy. Harbinger: in 1970 19 of the world's 50 largest banks were in the US, 16 in Europe and 11 in Japan. In 1990 there were no US banks in the top 20. In the service sector, 9 of the 10 largest firms are now in Japan.

* *

A. Gary Shilling's "Insight" makes this startling observation: "Consumer interest payments may now exceed interest earnings." They add, "Along with continuing layoffs, the debt of the 1980s that have to be paid down, and the weakness in home prices, this drain on consumer incomes looks set to further weaken the consumer's ability and willingness to spend -- and consequently to further undermine the pace of recovery."

* *

Harley, Harley . . They can't deliver the bikes; dealers across the nation are sold out. Now Harleys are all the rage overseas. Last week there were glowing Harley articles in both *Business Week* and *Forbes*. Yet, the stock has not been hitting new highs. Is the best out, is the Harley news at the point where it can't get any better? I don't know, but I do know the overseas business could become huge. Also, Harley is starting its own credit agency.

* *

A new *US News & World Report* poll finds that a full 45% of those polled say they would consider voting for Perot today -- a 14 point increase since the start of Clinton's term. The poll describes Perot supporters as "a movement of the alienated middle class -- as large as 25% of the electorate." They add, "In a hypothetical race, Perot runs dead even with the president." The poll shows that 67% of Americans have favorable feelings towards Perot compared with 53% for Clinton. Russell comment: I think the US middle class feels raped by Clinton. The last thing they wanted was higher taxes -- what they were promised were lower taxes and a real attack on the federal deficit. What they got were higher taxes and more spending. Personally, I'm surprised that Clinton has any popularity at all.

* *

Baseball is in for MAJOR financial changes. Under the last agreement, which was a four-year $1.06 billion deal with CBS, each team received a little more than $10 million a year. No longer. The league just signed a six-year deal (to be voted on) in which there will be three partners -- the league, ABC and NBC. It will be a separate venture that "will be responsible for administering the product, and for the marketing and sales of major league baseball." But under this new pact the team owners won't get a cent up front. So its uncertain how much the teams will get from the new set-up. Last year CBS took in $151 million in net sales on its baseball telecasts. If that's near the figure the new pact will bring in, then the teams will receive less than $120 million beginning in 1994 with the remainder going to the networks. The teams will also be negotiating a deal with one of the cable networks for additional games. BUT income is going to be down. Instead of getting around $14 million a year from network TV and cable, the teams will now get around $4 to $5 million. Result -- the sky-high baseball salaries may be history.

* *

Baseball may have its financial troubles but not the Federal Reserve Board. This independent agency has never been audited, and is free from Executive-branch control. It draws its operating money from interest on its Treasury bond holdings. Fed Chairman Greenspan earns $133,400 a year, and the 12 Board presidents earn from $152,800 to the highest -- $257,700 (the highest is $7,700 more than Clinton will earn this year). Top officials of the Fed are provided with Fed-owned sedans for use at home and at work. Fed employees are reimbursed for membership dues in certain clubs (the NY Fed paid out $67,000 in dues during 1990-91). Over the last three years the Fed disbursed more than $2 million in moving expenses to just 17 officials or $118,387 per move. A new vice-president at the Cleveland Fed got $181,905 to move from N. Carolina. The San Francisco Fed shelled out more than $1 million to move nine employees during the same period. Ah, for the life of a Fed official. Some kids grow up wanting to be president of the US. I told my boy, Ryan, "Forget being president of the US -- shoot for the presidency of a Federal Reserve Bank, it's a much better life."

* *

September, that's the month that has New York's midtown department stores trembling. For in September Barneys is due to move smack in the middle of New York's swankiest neighborhood on Madison Avenue. Some of the biggest designer names such as Chanel and Ralph Lauren are refusing to sell Barneys and even Giorgio Armani tried to refuse to sell, but he was legally forced to relent. It's going to be a retail battle and it's already been named the "Battle of the Bs": Barneys, Bendel, and Bergdorf. Life in the big city, it's never easy.

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A year ago *Time* magazine unveiled its bright new format. Personally, I thought it was a mess, and I hated it. Evidently, I wasn't alone. *Time's* new managing editor, Jim Gaines, is taking the magazine back to its roots. It's going to deal with the news. Gaines is also taking *Time* away from its preoccupation with analysis. Information is going to be the new key. "Our business," says Gaines, "is news."

* *

The way to get really rich is to have or receive a chunk of stock in the company where you work. Some rich CEO's with their stock ownership: Paul Fireman of Reebok owns $584 million in stock, Roberto Goizueta owns $306 million in Coca Cola, Craig McCaw owns $518 million in McCaw Cellular, Michael Eisner owns $122 million in Disney, J.F. O'Reilly owns $113 million in HJ Heinz, and so on.

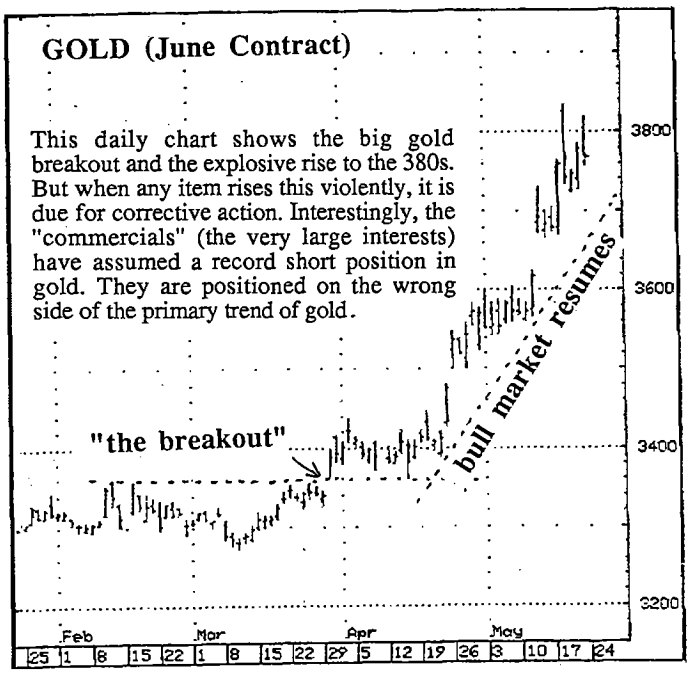
* *

Hard Rock Cafe Bldg. In La Jolla Brings $4.1 Million

The downtown La Jolla building that is home to the Hard Rock Cafe has been sold for $4.1 million, or less than half the value of a December 1988 loan for $8.5 million the property once secured.

Home prices in La Jolla (based on the latest sales) are down 18% from last year. This little clip from our local paper is worth studying. Mmm, you might say that commercial property is not even faring are well as homes.

But listen, we've still got the greatest weather in the country.


GOLD (June Contract)
This daily chart shows the big gold breakout and the explosive rise to the 380s. But when any item rises this violently, it is due for corrective action. Interestingly, the "commercials" (the very large interests) have assumed a record short position in gold. They are positioned on the wrong side of the primary trend of gold.
"the breakout"
bull market resumes
3800
3600
3400
3200
Feb
Mar
Apr
May
25 1 8 15 22 1 8 15 22 29 5 12 19 26 3 10 17 24

GOLD: *"Executive order: By virtue of the authority vested in me by Section 5(B) of the Act of Oct. 6, 1917, as amended by section 2 of the Act of March 9, 1933 . . ., in which Congress declared that a serious emergency exists, I as President, do declare that the national emergency still exists; that the continued private hoarding of gold and silver by subjects of the United States poses a grave threat to the peace, equal justice, and well-being of the United States; and that appropriate measures must be taken immediately to protect the interests of our people.*

"Therefore, pursuant to the above authority, I hereby proclaim that such gold and silver holdings are prohibited, and that all such coin, bullion or other possessions of gold and silver be tendered within fourteen days to agents of the Government of the United States for compensation at the official price, in the legal tender of the Government. All safe deposit boxes in banks or financial institutions have been sealed, pending action in the due course of the law. All sales or purchases or movements of such gold and silver within the borders of the United States and its territories, and all foreign exchange transactions or movements of such metals across the border are hereby prohibited.

"Your possession of these proscribed metals and/or your maintenance of a safe-deposit box to store them is known to the government from bank and insurance records. Therefore, be advised that your vault box must remain sealed, and may only be opened in the presence of an agent of the Internal Revenue Service.

"By lawful Order given this day, the President of the United States."

So went the order of April 5, 1933, prohibiting the selling, buying or owning of gold or silver. In so doing, the government of the US ordered its citizens to turn in their precious metals for "legal tender" paper.

Could such an event happen again? Anything, of course, is possible, but I doubt that it will happen again. First, the US government has denigrated gold, so to prohibit owning it would (by implication) invest gold with great power (which is the last thing the politicians want to do). Second, the US government has been in the business of minting and selling gold coins. To reverse that program and suddenly outlaw the coins that they have been asking you to buy would be outrageous. Third, there would be no point to outlawing gold and silver, since the dollar today is not redeemable in gold, and therefore the dollar has no connection with gold. Finally, in today's angry, violent world I doubt that Americans would obey an order to turn in their gold (any more than they would obey an order to turn in their guns).

THE EMBEZZLED SAVINGS OF AMERICANS
(Billions of Dollars)*

During Year	Relative Purchasing Power of the Dollar
1939	100.0
1940	99.3
41	90.3
42	82.8
43	80.5
44	78.7
45	76.9
46	65.1
47	59.8
48	58.1
49	59.3
1950	56.0
51	52.8
52	52.4
53	52.0
54	52.4
55	52.2
56	50.2
57	49.3
58	48.4
59	47.6
1960	47.0
61	46.7
62	46.1
63	45.3
64	44.9
65	44.0
66	42.5
67	41.2
68	39.4
69	37.1
1970	35.2
71	34.1
72	32.9
73	30.3
74	27.0
75	25.2
76	24.1
77	22.5
78	20.7
79	18.3
1980	16.2
81	14.9
82	14.3
83	13.8
84	13.3
85	12.8
86	12.7
87	12.1
88	11.6
89	11.1
1990	10.5
91	10.2
92	9.9

At any rate, I receive many letters from subscribers who worry that our government might again outlaw ownership of precious metals. I don't think it will happen. No, change that -- I'm convinced that it won't happen.

Why does the government hate gold? Easy, gold is real money, it possesses intrinsic value. Dollars are strictly a government creation -- dollars are legal tender by government edict. A dollar has absolutely no intrinsic value, and today there exists no definition of a dollar (a dollar used to be defined in terms of a specific amount of gold or silver, remember?).

All of today's dollars are the product and creation of the US central bank, known as the Federal Reserve. Dollars are created "out of thin air" through a process of monetizing debt. Dollars are created by the Fed at will, and this is the reason why, over the years, the dollar has persistently lost purchasing power.

So when you think about it, it is incredible that anyone would trade his time, his skill and his labor for pieces of paper issued by a government that consistently spends more than it takes in.

The public is ignorant but not stupid. Sooner or later (usually much later) they see the truth of a situation. It is a fact that all government deficits breed one of two things -- inflation or bankruptcy of the currency. Since the Federal Reserve can create all the money it wants out of nothing, it is obvious that inflation in the US will ultimately win over bankruptcy. It's the "inflate or die" syndrome that I've written about for years. Which do you think the US government will choose -- inflation or death (bankruptcy)?

The US is currently creating federal deficits at the rate of $1.3 billion a day. Does anyone seriously believe that the US government will not attempt to handle these deficits via inflation?

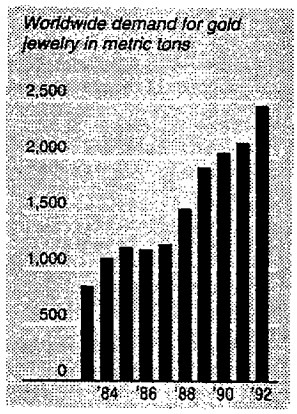
Lest you are unaware of history, I've included this statistical rundown of the purchasing power of the dollar (courtesy of the *American Institute for Economic Research,* Great Barrington, Mass. 01230). Here we see what has happened to the dollar in terms of purchasing power and as a store of value. During this same period, gold has maintained its purchasing power.

Many years ago Hamilton Bolton (founder of the *Bank Credit Analyst)* noted that it's taking an increasing amount of credit creation to produce less and less in the way of gross national product. One major reason for this is the rising mountain of debt that must be carried. This situation presents the perfect background for inflation. The only question is the timing.

I believe that behind the recent rise in gold is the recognition that the US must and will inflate in the period ahead. Thus rising gold prices are simply an early sign of a mass investor movement out of financial assets and into tangible or real assets.

But wait, there's a surprise about gold -- the surprise is that you don't have to wait for inflation in order to see gold go up. The reason -- the supply/demand equation is now in favor of gold. Currently, the total gold supply from gold mines plus gold scrap equals about 2,200 tons a year. But on the other side of the equation, demand is exploding -- currently, to about 3,500 tons a year.

The World Gold Council reports that for the full year 1992 demand for gold rose 11%. And for the first quarter of 1993 demand rose a whopping 24%. Gold demand from India was up 93%, for China up 36%, and for developing nations taken together up 36%.



Demand for gold jewelry is also rocketing -- in 1984 jewelry consumed 1,200 metric tons of gold. By 1988 demand rose to 1,500 tons. In 1990 it was over 2,000 tons. By 1991 demand rose to 2,100 tons, and for 1992 demand careened to just under 2,500 metric tons.

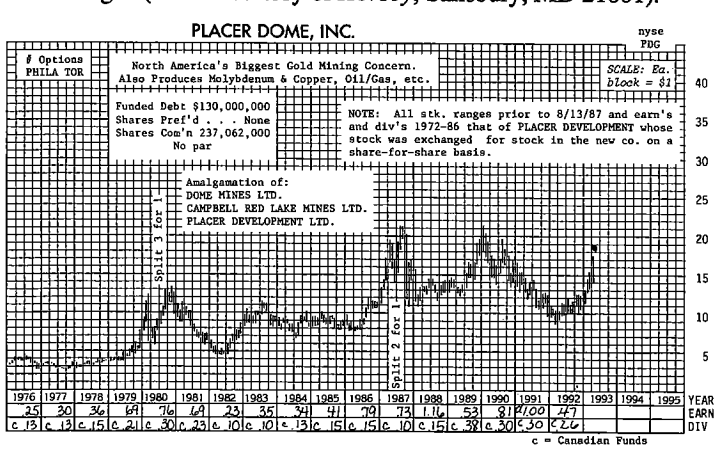
This *NY Times* chart shows the demand for gold in the jewelry sector alone. Jewelry demand alone has surpassed annual world gold production.

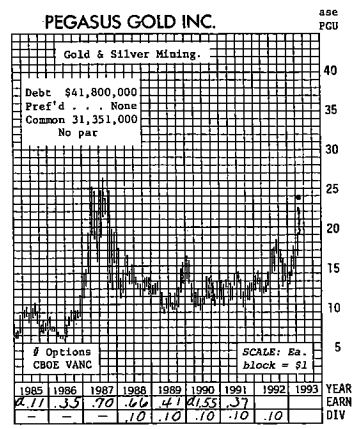
During 1992 central banks sold about 600 metric tons of gold, but this supply was quickly absorbed. My guess is that the central banks (in the face of rising gold prices) now realize their mistake, and they will no longer be sellers. Russia, formerly a major supplier, probably sold most of its gold, and is no longer a factor in central bank sales.

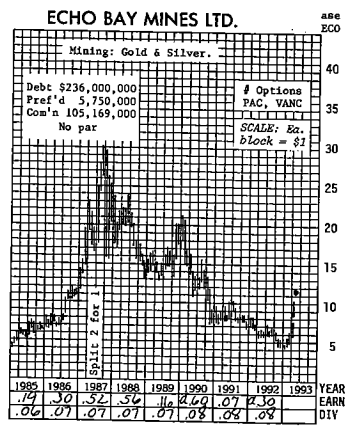
It is thought that China bought all of the 12.9 million ounces that the Dutch central bank sold. With China opening up and possessing one fifth of the world population, their appetite for gold is almost insatiable. The Chinese economy grew by 12.8% in 1992 and the latest figures show it is currently growing at a 13% rate. Inflation has become a serious problem in China, and their currency has been in a steady downtrend. The Chinese have no stock or bond markets to speak of so to protect themselves they have become huge buyers of gold.

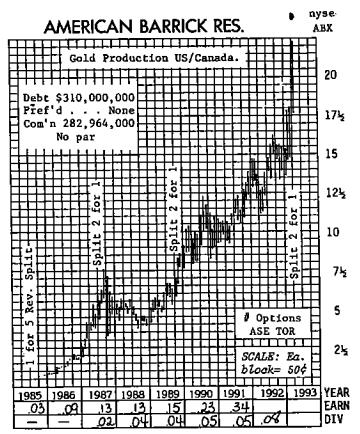
In the meantime, the overriding consideration is simple -- **THE BULL MARKET IN GOLD WHICH BEGAN AT THE 1985 LOWS -- HAS RESUMED.**

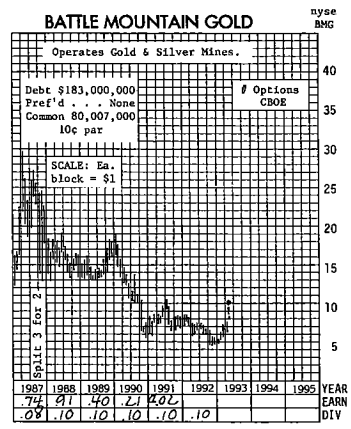
Note: I'm including a few long-range monthly charts. These charts will give you some perspective on what various gold stocks have been doing over the years. Most of these are older companies whose prices collapsed during the gold bear market of 1980-85. They are now coming off long bases. Dots on the chart represent recent highs (charts courtesy of *Horsey*, Salisbury, MD 21801).


PLACER DOME, INC.
nyse PDG
Options PHILA TOR
North America's Biggest Gold Mining Concern. Also Produces Molybdenum & Copper, Oil/Gas, etc.
SCALE: Ea. block = $1
Funded Debt $130,000,000
Shares Pref'd . . . None
Shares Com'n 237,062,000
No par
NOTE: All stk. ranges prior to 8/13/87 and earn's and div's 1972-86 that of PLACER DEVELOPMENT whose stock was exchanged for stock in the new co. on a share-for-share basis.
Amalgamation of:
DOME MINES LTD.
CANFIELD RED LAKE MINES LTD.
PLACER DEVELOPMENT LTD.
Split 3 for 1
Split 2 for 1
40
35
30
25
20
15
10
5
1976 1977 1978 1979 1980 1981 1982 1983 1984 1985 1986 1987 1988 1989 1990 1991 1992 1993 1994 1995 YEAR
.25 .30 .36 .69 .76 .69 .23 .35 .34 .41 .79 .73 1.16 .53 .81 d.00 .47 EARN
c.13 c.13 c.15 c.21 c.30 c.23 c.10 c.10 c.13 c.15 c.15 c.10 c.15 c.38 c.30 c.30 c.26 DIV
c = Canadian Funds









LATE NOTES: First Treasury Secretary Bentsen popped off in public about wanting a higher yen (translation, a lower dollar) in order to help our trade deficit with Japan. The dollar promptly fell out of bed. Bentsen relented. Then last week Commerce Secretary Brown mouthed off about wanting "a market driven exchange-rate correction" (translation, a lower dollar). Believe me, you're playing with fire when you make stupid statements about wanting a lower dollar. The foreign exchange traders tend to take statements from government officials seriously. It's really a shame that we have so many amateurs ("economic illiterates") in Washington running the country.

I think the big picture is that Clinton ("Mr. Trial Balloon") and his people just don't know what they're doing. I'm not saying they aren't intelligent, they're just "lost in space," and an administration that doesn't know what it's doing is an administration that's going to create trouble. The trouble, so far, is showing in the dollar and in gold -- and in the weakness of a good many stock groups.

The vastly overvalued stock market holds together as it continues to trade off current low, low interest rates. There are only three phenomena that could cause interest rates to rise: (1) accelerating strength in the economy, (2) rising inflation, (3) a run on the dollar. So far there are no signs of #1. There are a few hints of #2. As for # 3, IF gold continues to rise, it could very well cause a run on the dollar. If people have an urge to swap dollars for gold, you've got to give them an incentive to stay with the paper. That incentive is higher rates. Which is the reason why the Fed and the administration are so terrified of rising gold prices.

As for gold, it has spiked up to the 380's (June contract), and spikes need to be corrected. So far, gold has given up remarkably little of its gains, but I would be surprised if gold went higher from here without a spate of consolidation and correction. So far, however, I grade the gold action as "powerful."

NEXT MAILING: June 9, 1993